In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 728

PATRICK C. GRANEY AND THELMA GRANEY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The issue in this case is whether the district court and court of appeals were correct in holding an agreement between petitioner [1] and Gulf Mining Company (Gulf) to be an option to purchase, rather than an outright sale of, 500 shares of Gulf stock. The parties agree that if the agreement in question was one of option and not of sale, the difference between the option price and the fair market value of the stock at the time of exercise is includible in petitioner's income for the year of exercise, Treas. Reg., Section 1.61-2(d)(2), but that if the agreement was one of

[1] Thelma Graney is a party solely because she filed joint returns with her husband (Pet. 17). "Petitioner" refers, therefore, to Patrick C. Graney.

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immediate sale, petitioner's income is to be measured by the market value at the time the agreement was executed.

Gulf and West Gulf Coal Company (West Gulf), planned to merge and desired petitioner to assume the presidency of Gulf, the surviving corporation. As an inducement to petitioner, Gulf and West Gulf, on May 1, 1953, entered into an agreement with petitioner entitled "THIS STOCK OPTION AGREEMENT." (Pet. 17–18.) Petititioner was granted "the exclusive right and option to purchase * * * FIVE HUNDRED (500) shares of the capital stock of Gulf * * *" for $25 per share at any time up to May 31, 1958. In the event that the merger was not consummated, the agreement was to be null and void. A bank was to hold the shares in escrow pending petitioner's exercise of the rights. The bank was to return to Gulf for cancellation any shares that petitioner failed to acquire. (Pet. 18–19; Supp. R. 25.)[2]

The merger was consummated, and, on July 1, 1953, Gulf issued appropriate stock certificates and delivered them to the bank. Petitioner exercised his rights under the agreement to acquire 100 shares in each of the years 1953, 1954 and 1955. In 1956 he acquired the last 200 shares. Less than a month later, and but three months after the 1955 acquisition, petitioner sold all 500 shares for $190 per share. (Pet. 19–20.)

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[2] "Supp. R." references are to the appendix to the brief for the Government in the Court of Appeals.

Petitioner originally treated the agreement as an option for federal income tax purposes. He reported in his tax returns for each year ordinary income in the amount of $50 for each share acquired during the year—the difference between his purchase price and the $75 per share fair market value of the stock in 1953. The Commissioner of Internal Revenue asserted that the fair market value of the shares when petitioner acquired them was the proper measure of his income, and that the value of the 300 shares acquired in 1955 and 1956 was $190 per share, with resulting income of $165 rather than $50 per share. Petitioner paid the resulting deficiencies.[3] The Commissioner rejected timely claims for refunds, and petitioner then sued for a refund in the district court (Pet. 17, 20–21).

The district court rejected petitioner's argument that the agreement was not an option agreement and that he had acquired all 500 shares of stock in 1953 (Pet. 17–23). The court of appeals affirmed on the district court's opinion (Pet. 24–25).

The courts below correctly interpreted the agreement at issue. There is no conflict or other basis for review in this Court.

1. Petitioner is wrong in arguing (Pet. 9) that the agreement accorded him all the significant benefits of ownership of the stock. He was accorded two rights of stock ownership: to vote, and to receive dividends. Possession of these rights is far from pos-

[3] Five percent negligence penalties were imposed. The district court found that the penalties were not justified, and granted petitioner a refund in their amount (Pet. 23).

session of all significant rights of ownership.[4] An optionee may possess some incidents of ownership although a sale has not taken place. See, *e.g.*, *Rich Lumber Co.* v. *United States*, 237 F. 2d 424 (C.A. 1). The question is whether the totality of the evidence shows the agreement to be an option.

Although the district court did not, as petitioner contends (Pet. 7), base its decision solely on the failure of the agreement to impose on petitioner an obligation to buy the stock, it did rely on that fact more than any other. This approach was plainly correct; the lack of an obligation to purchase is the hallmark of an option. *Lucas* v. *North Texas Lumber Co.*, 281 U.S. 11, 13. The district court's opinion, moreover, recognized a number of highly significant factors, all of which indicated the agreement to be an option. Thus the court noted that the agreement provided for disposition of stock not purchased, that neither the petitioner nor the corporation treated petitioner as owner of the stock on their books, records or federal tax returns until after the option was exercised, and that the parties to the agreement intentionally used the term option in its technical and legal sense (Pet. 21-22).

[4] Petitioner claimed in the court of appeals to have had the right to transfer the stock in question (Br. 6). He has now apparently abandoned this position and points to transferability of his rights under the agreement as indicating that a sale had taken place (Pet. 9).

2. There is nothing to petitioner's claim that other cases conflict with the decision here. In some of the cited cases a sale was found because of factors not present here. Thus, in *Moore* v. *Commissioner*, 124 F. 2d 991 (C.A. 7), the buyer paid almost one-half the purchase price on entering the agreement and also paid interest on the unpaid balance. In *Chaplin* v. *Commissioner*, 136 F. 2d 298 (C.A. 9), *United States* v. *Amalgamated Sugar Co.*, 72 F. 2d 755 (C.A. 10), and *Schneider* v. *Duffy*, 43 F. 2d 642 (D. N.J.), the agreements had express language showing the parties intended to effect a sale.

Those cases where no sale existed are consistent with the result here both on their facts and in their reasoning. In *MacDonald* v. *Commissioner*, 76 F. 2d 513 (C.A. 2), the court decided that a contract entered into by a taxpayer was actually a joint venture. The determinative factor was a lack of intent to vest title to the stock in the purported purchasers at the time the agreement was executed, 76 F. 2d at 514, an intent equally absent here. And *United States Industrial Alcohol Co.* v. *Helvering*, 137 F. 2d 511 (C.A. 2), was simply a case when the courts found the purported buyer without an obligation to purchase.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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